Ethical Business Practice
and
Ethical Business Regulation

Integrating Theories of Regulation, Enforcement, Compliance, Culture and Ethics

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Traditional Regulatory Enforcement Paradigm

- Rules – perfectly written

  - Compliance – complete

    - Breach – all immediately identified

      • Sanction – deterrence

        • Compliance – complete

Evidence – Multiple Sources/Types

1. ## Behavioural psychology – based on extensive research
   - We are 'predictably irrational', not the rational actors of economic theory
   - Good people do stupid things, usually not seriously
   - We are strongly influenced by social groups and by our concept of fairness

2. ## Genetic biology and its evolution
   - Genetic mutation in *homo sapiens* from defensive (blame) to an ability to make moral judgments (an ethical gene)
   - That enabled our species to be able to <u>collaborate</u>, which was critical to our success
   - Because collaboration is based on <u>trust</u>, which is based on evidence

3. ## Regulatory practice: research (eg responsive regulation) and published enforcement policies
   - Many effective regulators use 'advice and support' rather than deterrence or confrontation for most regulatees
   - 'Have a big stick, talk softly': still need effective powers
   - UK policy of 'Regulated self-assurance' and 'earned recognition': *Regulatory Futures Review* (Cabinet Office, 2017)

4. ## Evidence of what does *not* work
   - Empirical studies on whether there is any deterrent effect (not much effect), and on the unintended consequences of hard enforcement on good people
   - Empirical evidence from enforcement practice

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Questions

- Why do people conform to or break rules?

- How do we get people to conform to rules?

- How can regulators/enforcers/compliance support ethical behaviour, compliance, performance improvement, growth, innovation?

- How should we design "enforcement" policies and regulatory systems?

- How should we design "compliance" systems in commercial organisations?

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Models of Regulation and Compliance

"MY DEAR CAPTAIN RAVENDER," SAYS HE. "OF ALL THE MEN ON EARTH, I WANTED TO SEE YOU MOST. I WAS ON MY WAY TO YOU."

Annual FCA fines 2011/12–2015/16 £million (FCA, 2016)

	2009/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Number of Fines								
Individuals				40	19	22	24	15
Firms				23	26	27	27	17
Total				63	45	49	51	32
Aggregate Fines (£m)								
Individuals				19.9	5.0	3.9	7.1	16.2
Firms				58.9	422.2	416.9	1,403.1	874.0
Total	27.6	33.5	98.7	78.8	427.2	420.8	1,410.3	890.2

"Culture in financial services is widely accepted as a key root cause of the major conduct failings that have occurred within the industry in recent history, causing harm to both consumers and markets. ….
The financial services industry, in particular, has demonstrated instances of rate-rigging, rogue trading and mis-selling in the last 10 years since the global financial crisis. Despite record fines, increasing investigations and an expanding compliance industry, misconduct remains. Why? What have we not learned?"

Transforming culture in financial services (Financial Conduct Authority, 2018)

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Enforcement outputs: Occupational Safety Inspections in Britain, France and Germany

Number of inspections, pro-rated to the enterprise population 2011-2015 (Germany 2011 = 100)

Germany · Great Britain · France
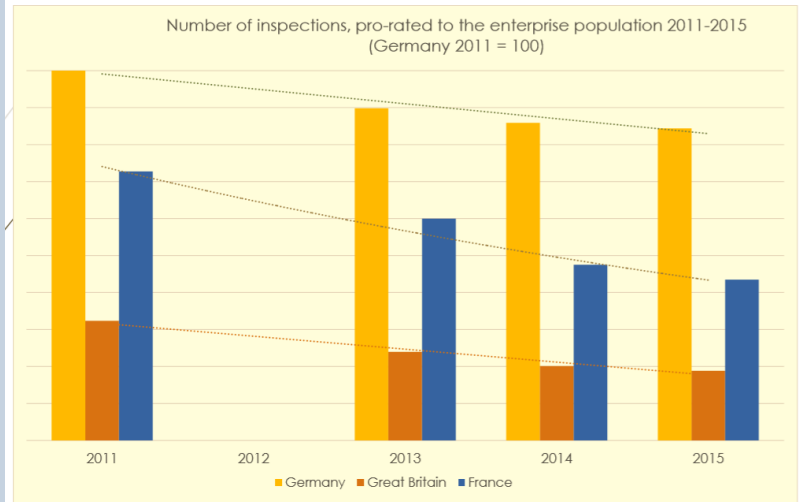
Fatal occupational accidents rate (per 100.000 workers), Eurostat, excluding transportation-related

Great Britain — Germany — France — EU 15 — EU 28 (EU 27 until 2008 included)
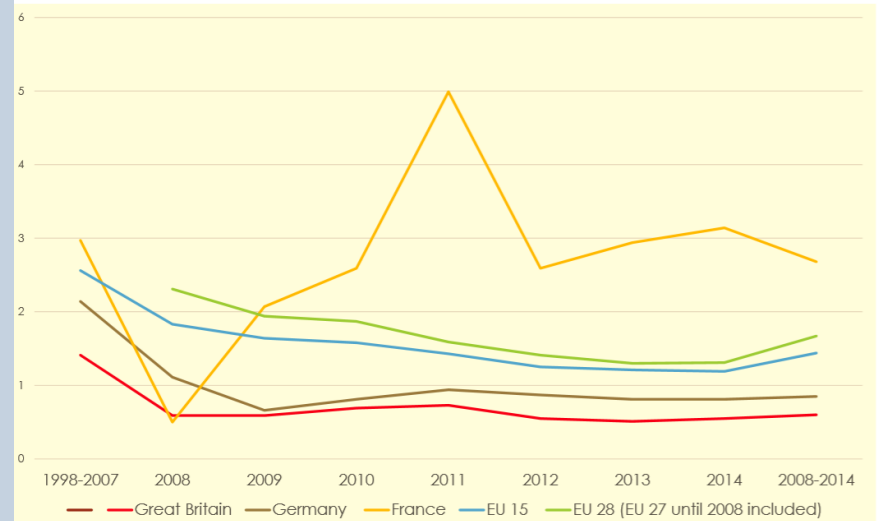
Florentin Blanc, *From Chasing Violations to Managing Risks* (Edward Elgar, 2018)

FAA NMAC introduced an offer of immunity from prosecution: pilot reporting increased dramatically (from 559 in 1965 to 2,230 in 1968); when retracted immunity in 1972, reporting dropped (to 231 in 1987) and remained low.
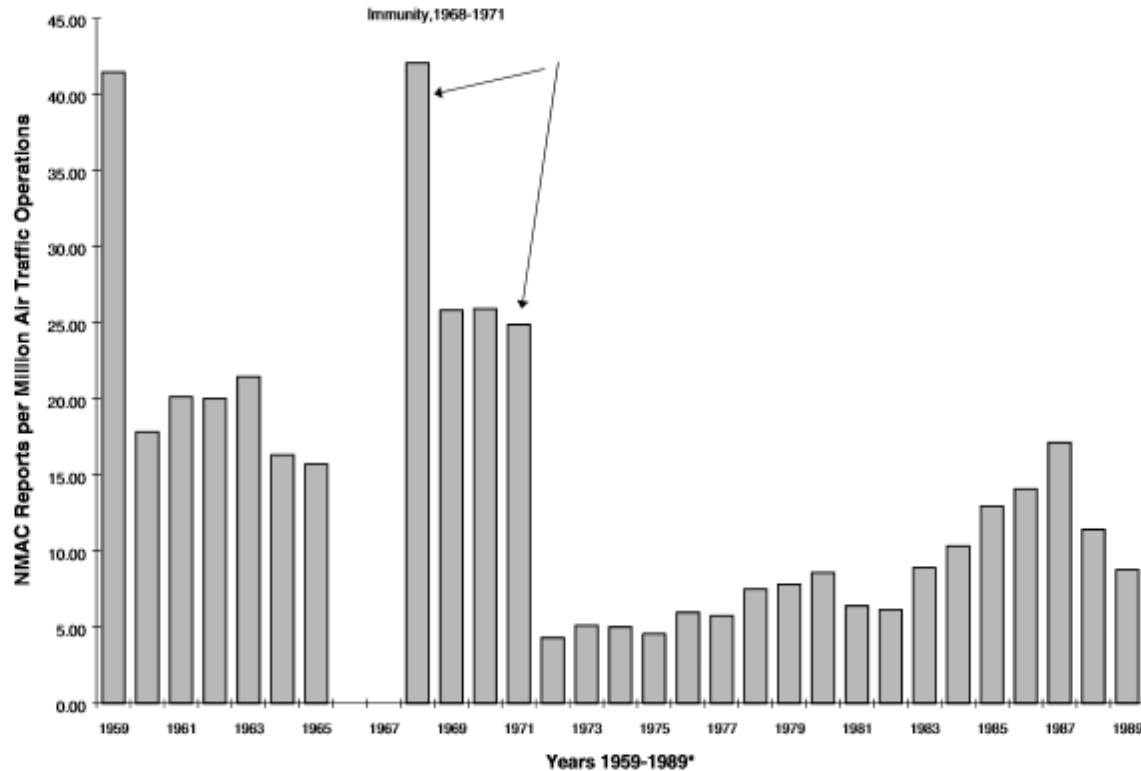
Figure 2: Pilot Reports of Near Midair Collisions (NMACs) (1959 to 1989) and Under Federal Aviation Administration Grant of Immunity (1968-1971)

SOURCE: Adapted from U.S. Federal Aviation Administration, Office of Aviation Policy and Planning (1999), and U.S. Federal Aviation Administration, Office of Aviation Safety (1987).

NOTE: Data missing for 1966 to 1967.

To achieve data flow, you need a no blame culture

Aviation safety case study

- *Open culture* of *questioning* decisions and *sharing* knowledge of mishaps – extensive free sharing of information

- *Just culture* of *accountability* without *blame* provided ethical intention

- Maintain *accountability* by constantly, visibly *contributing*

- Aims
    - constant monitoring of *performance*
    - constant learning and improving the *system* and its human operation.

- 'No blame' must operate in *every context*: system regulation, professional regulation, employment discipline, liability for harm, social

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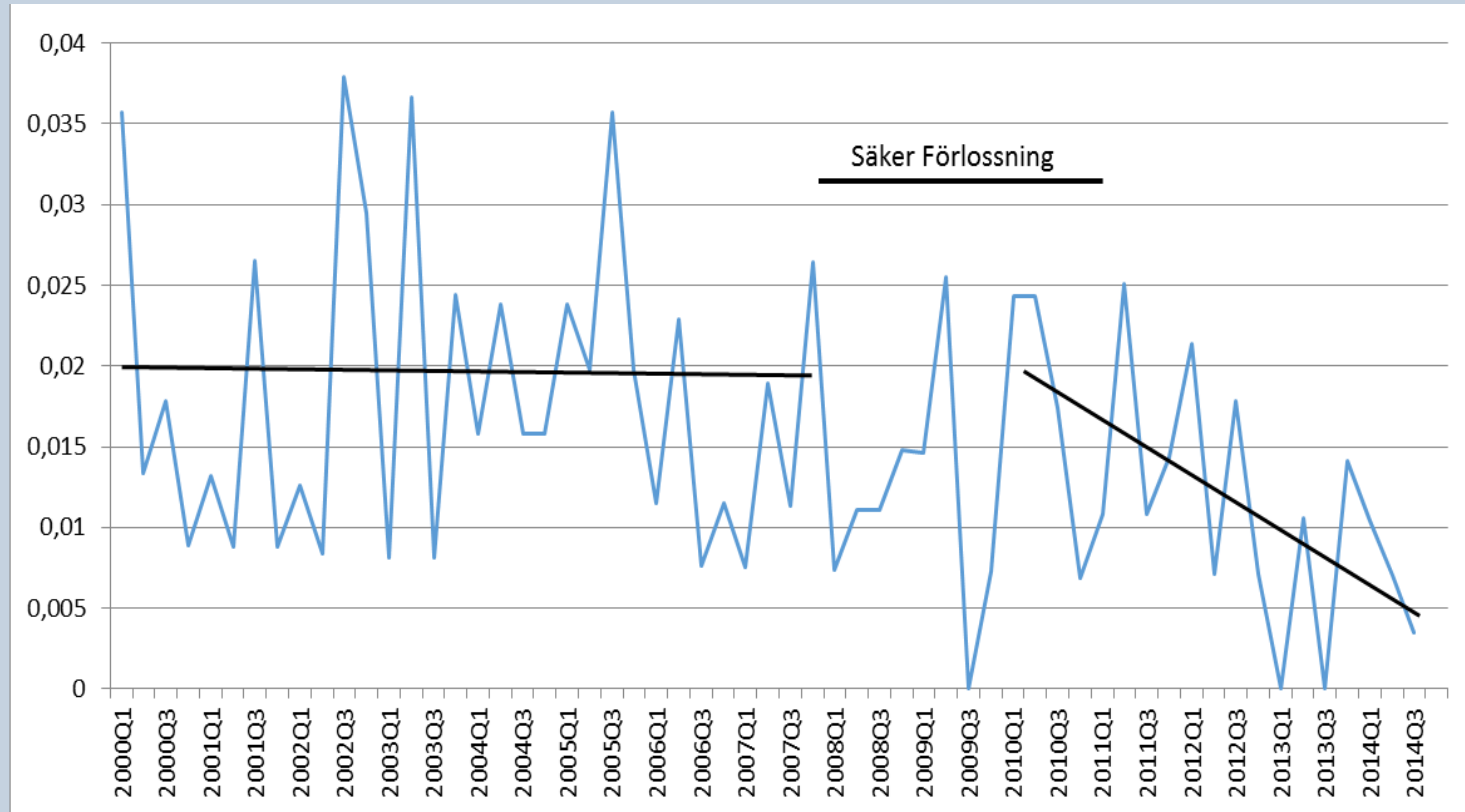
Using feedback data to drive improvements in practice and reduce cost

Swedish Patient Insurance: settled claims involving serious birth injuries 2000-2014, per quarter

CIVIL JUSTICE SYSTEMS

Law and Corporate Behaviour

Integrating Theories of Regulation, Enforcement, Compliance and Ethics

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Hart · CH Beck · Nomos

Department for Business Innovation & Skills

Better Regulation Delivery Office

Ethical Business Regulation: Understanding the Evidence

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February 2016

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Supportive	Mixed – moving left	Deterrence
Effective inspection and enforcement: implementing the Hampton vision in the Office of Fair Trading. A review supported by the Better Regulation Executive and National Audit Office (Better Regulation Executive, Department for Business Enterprise & Regulatory Reform and National Audit Office, 2008). *Toward Effective Governance of Financial Institutions* (Group of 30, 2012). *Civil Aviation Authority Regulatory Enforcement Policy* (Civil Aviation Authority, 2012). *Statement of consumer protection enforcement principles* (OFT, February 2012). *National Local Authority Enforcement Code. Health and Safety at Work. England, Scotland & Wales* (Health and Safety Executive, 2013). P Lunn, *Regulatory Policy and Behavioural Economics* (OECD, 2014). *Standards of Conduct. Treating Customers Fairly. Findings from the 2014 Challenge Panel* (Ofgem, March 2015). *Corporate Plan June 2015-March 2018* (Revenue Scotland, 2015). *Competition Policy: A better deal: boosting competition to bring down bills for families and firms* (HM Treasury, December 2015). *Corporate Governance and Business Integrity. A Stocktaking of Corporate Practices* (OECD, 2015). *Better Business for All and Growth* (Better Regulation Delivery Office, 2015). *Statement of principles for licensing and regulation* (Gambling Commission, 2015). *Food We Can Trust: Regulating the Future* (Food Standards Authority, 2016). *Consultation on Ofwat's approach to enforcement* (OFWAT, March 2016). *Farm Regulators' Charter* (DEFRA and Others, 2016). *Scottish Government Response to the Working Group on Consumer and Competition Policy for Scotland* (March 2016). *Monetary penalties for breaches of financial sanctions-guidance* (Office of Financial Sanctions Implementation, HM Treasury, 2017). *Enforcement Policy* (Regulatory Delivery, 2017). *Enforcement Policy* (Solicitors regulatory Authority, 2018)	*The Bribery Act 2010. Guidance about procedures which relevant commercial organisations can put into place to prevent persons associated with them from bribing (section 9 of the Bribery Act 2010)* (Ministry of Justice, 2011). *The Prudential Regulation Authority's Approach to Banking Supervision* (PRA, April 2013). *Enforcement and Sanctions – Guidance. Operational Instruction 1356_10, version 2* (Environment Agency, 2014). *Enforcement Guidelines on Complaints and Investigations* (OFGEM, June 2012). *Economic enforcement policy and penalties statement* (ORR, 2012). *Enhancing consumer protection, reducing regulatory restrictions: Summary of responses to the discussion paper and decision document* (Legal Services Board, April 2012). *The future of retail market regulation* (Ofgem, December 2015). *Enforcement policy* (Care Quality Commission, 2015). *Our Approach to Supervision* (Financial Conduct Authority, 2018); *Our Approach to Enforcement* (Financial Conduct Authority, 2018)	*OFT's Guidance as to the appropriate amount of a penalty* (Office of Fair Trading, 2012), OFT423. *Changing Banking for Good: Report of the Parliamentary Commission on Banking Standards: Volume I: Summary, and Conclusions and Recommendations HC Paper No.27-I, II* Parliamentary Commission on Banking Standards, 2013. NB *The Financial Conduct Authority: Approach to Regulation* (Financial Services Authority, June 2011). *The FCA's approach to advancing its objectives* (FCA, July 2013). FCA's Decision Procedure and Penalties (DEPP) Manual ("credible deterrence"). *Prioritisation principles for the CMA. Consultation document* (Competition & Markets Authority, 2014). Serious Fraud Office. U.S. Department of Justice Memorandum, "Individual Accountability for Corporate Wrongdoing," September 9, 2015. *Penalty guidelines. s.392 Communications Act 2003* (Ofcom, December 2015).

UK *Regulatory Futures Review*, January 2017

Regulators should move towards (and report on):
'Regulated self-assurance' and 'earned recognition'

> Effective regulatory delivery models should focus, as far as possible, on outcomes, rather than on a rules-based approach. Organisations should be able to find the best way to self-assure that they are meeting their legal responsibilities, and earn recognition that they are doing this. Where this occurs, the role of regulators should be mainly to provide information and advice to ensure that organisations assure themselves effectively and reliably, and intervene when they do not.
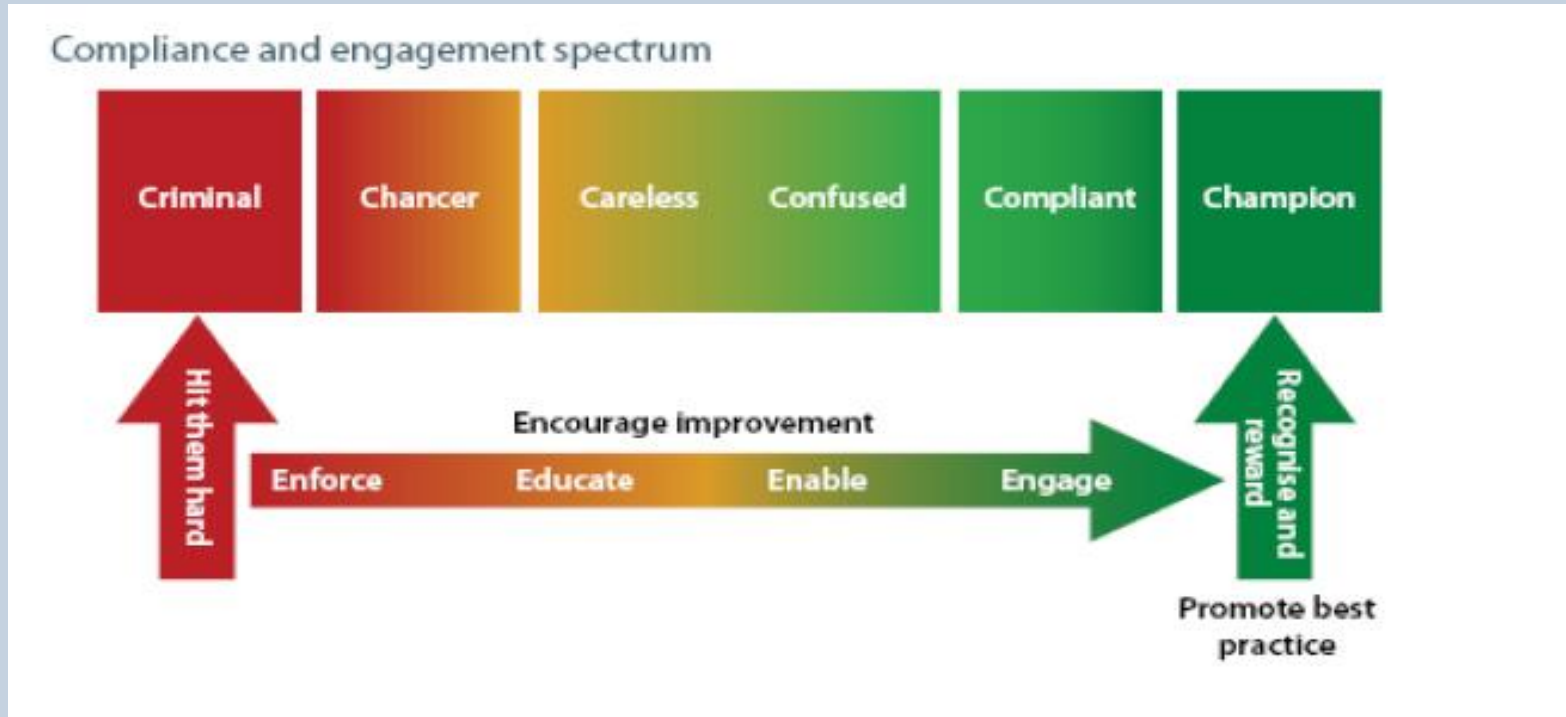
Potential public sector savings of £620 million pa
Influence of EBR:

> In practice this means that businesses who 'do the right thing' should be regulated with a very light touch. As part of this, regulators should encourage more ethical business practices. However, where regulated entities do not 'do the right thing' and do not follow ethical business practices, redress should be sought.
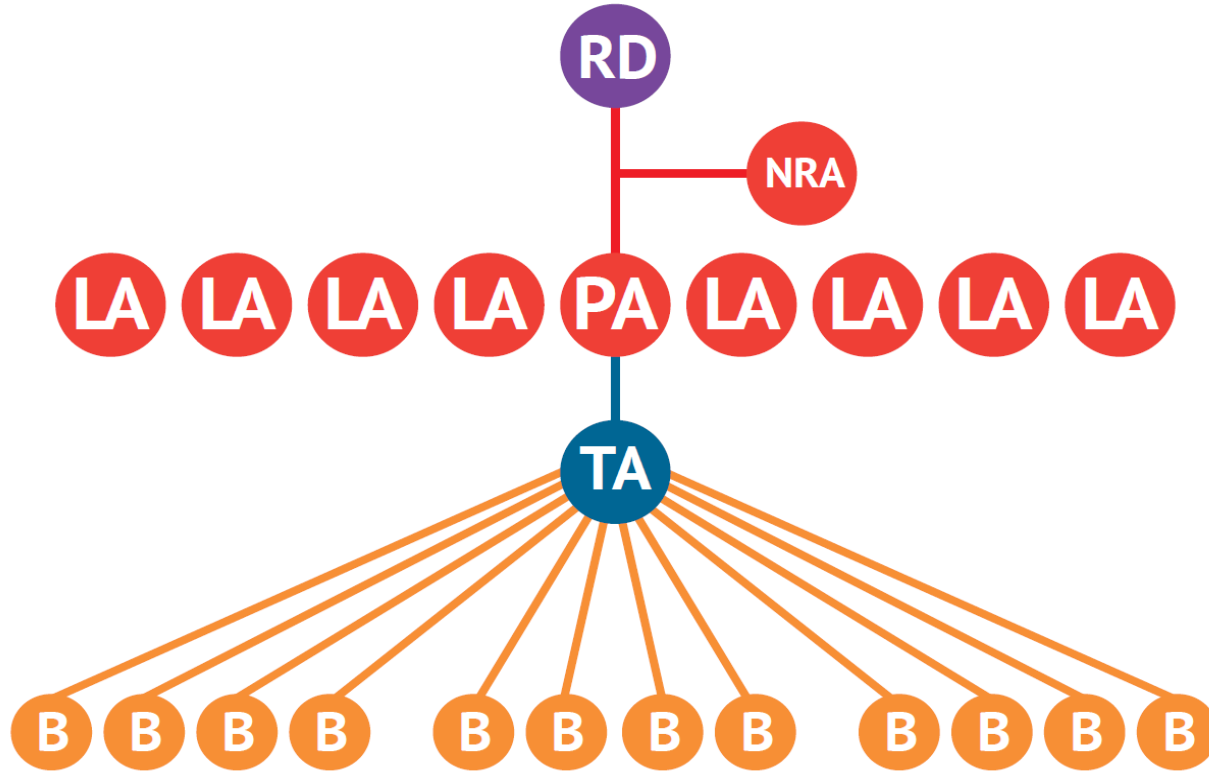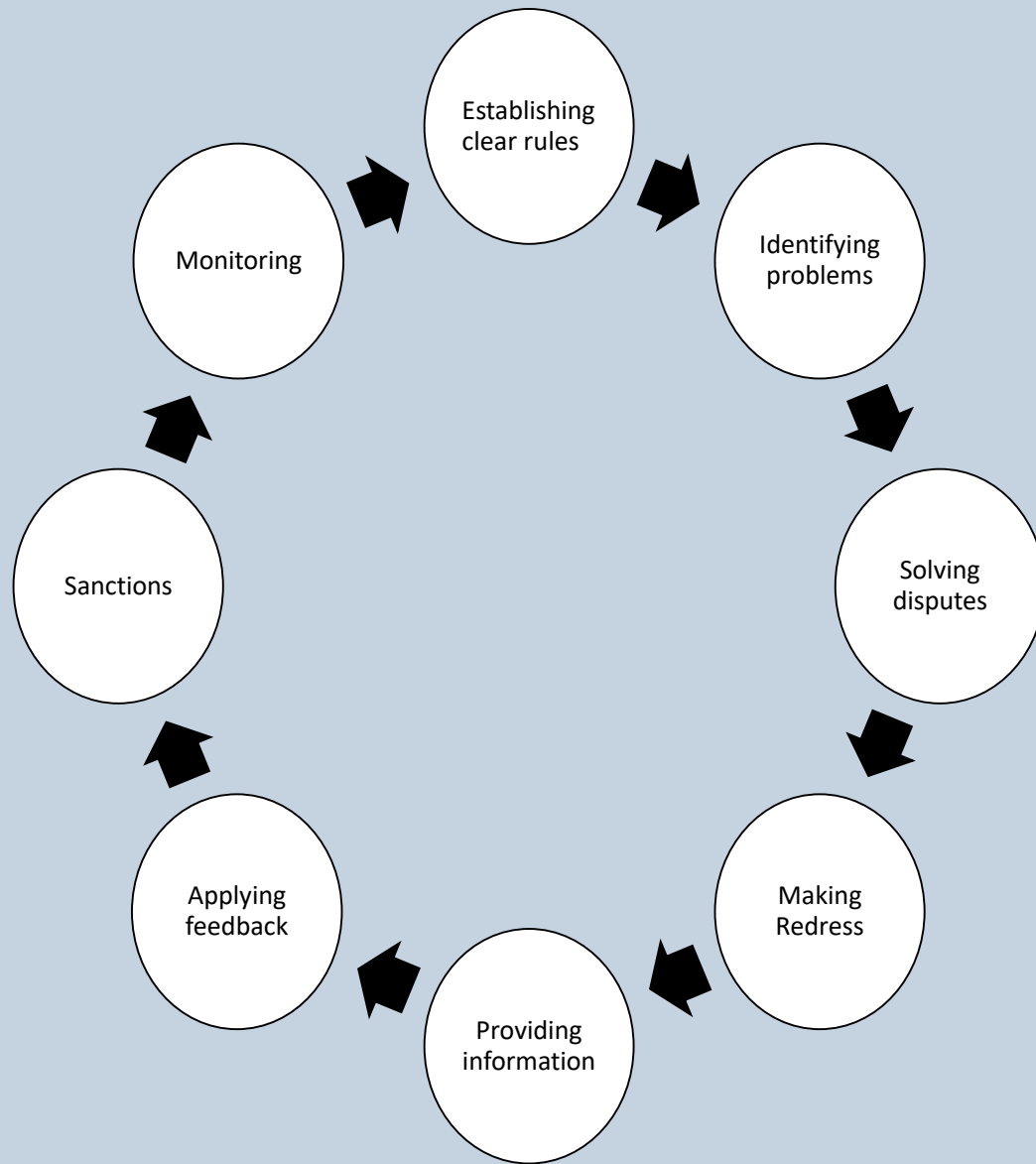
Regulators need a diverse tool box

Segmented Proportionate Enforcement:
Scottish Environmental Protection Agency

Compliance and engagement spectrum

Criminal | Chancer | Careless | Confused | Compliant | Champion

Hit them hard

Encourage improvement

Enforce | Educate | Enable | Engage

Recognise and reward
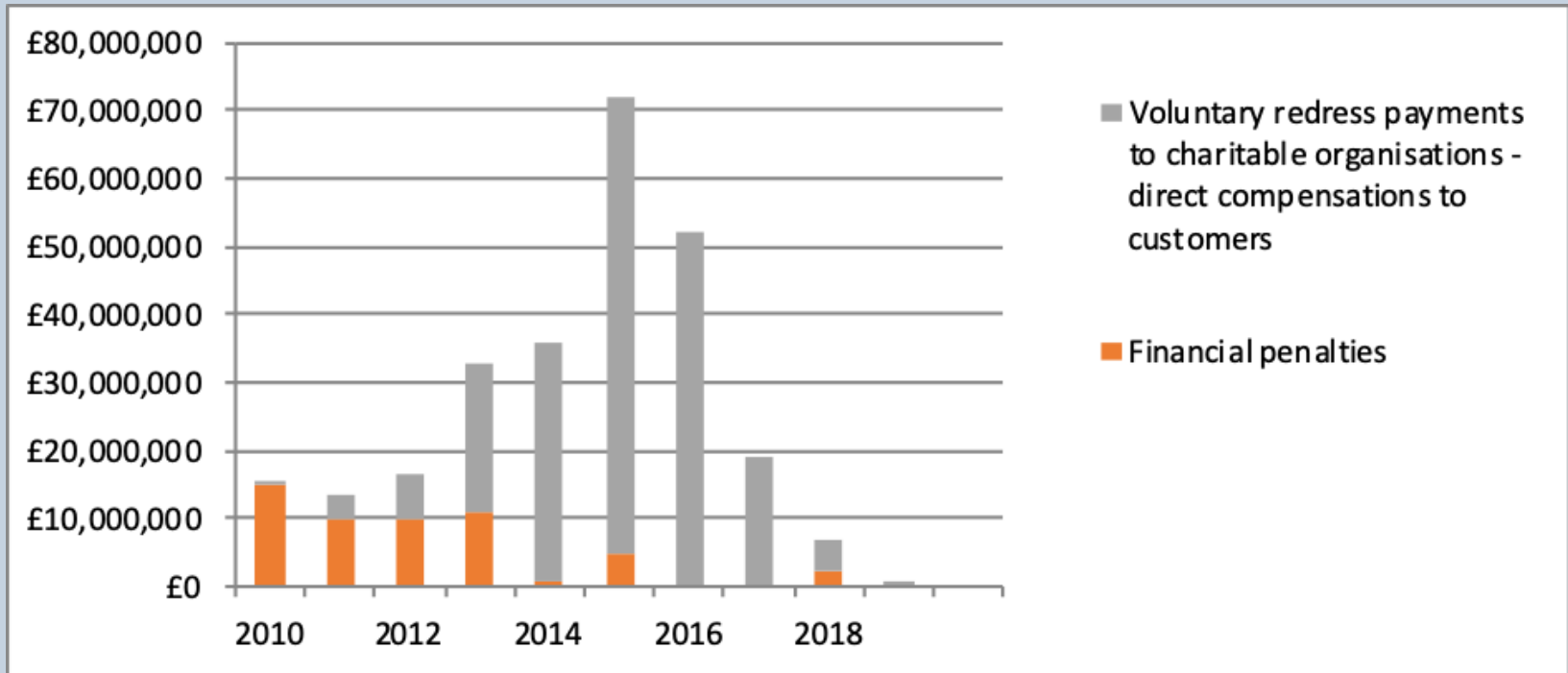
Promote best practice

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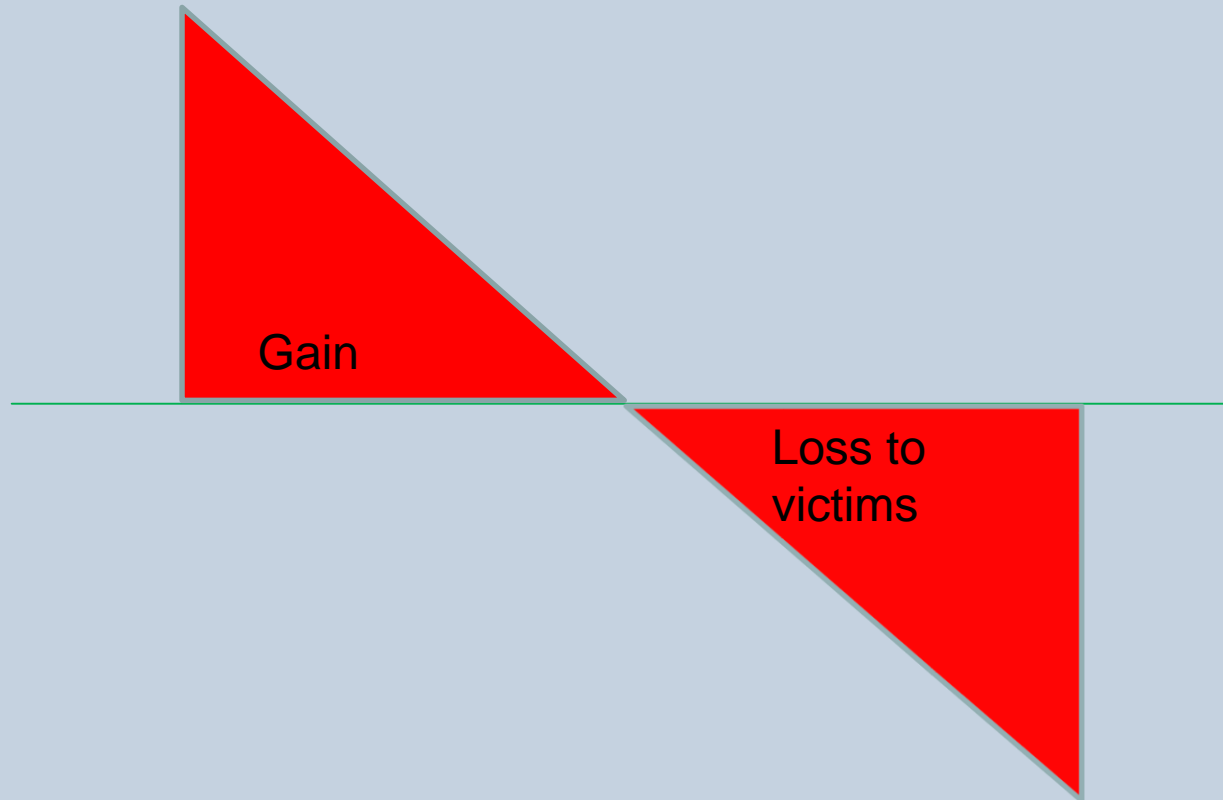
THE PRIMARY AUTHORITY SCHEME - DEVELOPED

Ofgem: penalties and redress

Maintaining a level playing field

Gain

Loss to victims

Price setting – water in Scotland

- Wider consultation – Customer Forum
- More issues on the table – and solved
- Longer timescale
- Cheaper – fewer consultants

Drinking Water Inspectorate – England & Wales

The Compliance Risk Index & the Event Risk Index

- A new measure designed to quantify and improve business practices called.
- This focuses on the scale and the duration of the effect, the risk associated with the specific parameters or event and the outcomes of the Inspector's assessment.
- Decreasing figures indicate improving performance

http://dwi.defra.gov.uk
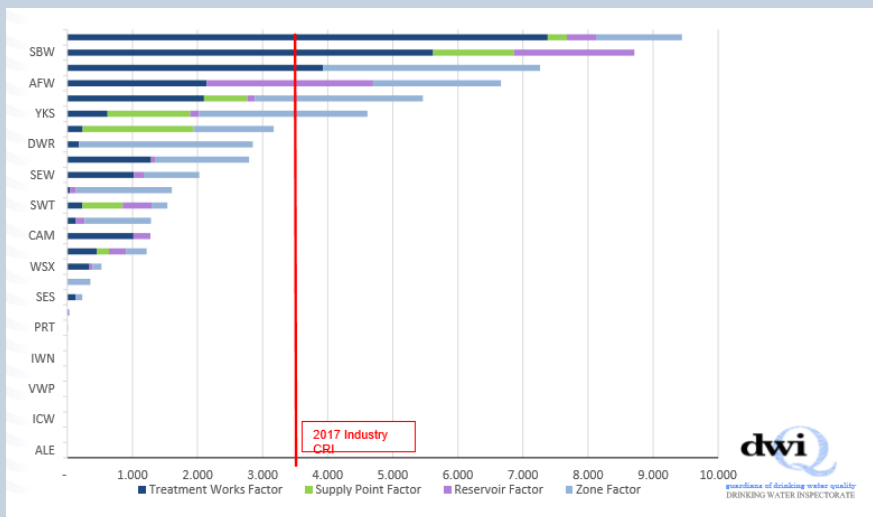
Company Comparison CRI

Analysing ERI

Reduction in population affected and duration over 3 years
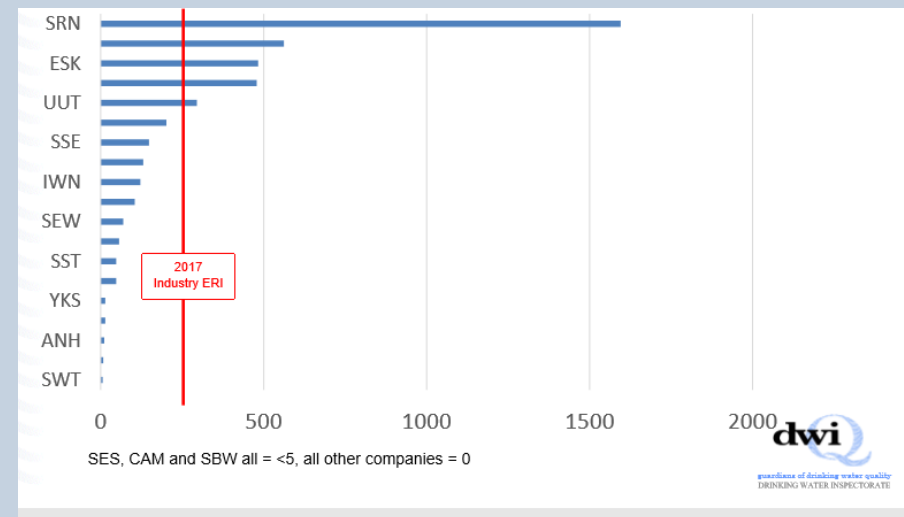
3 Year Population and Duration

Measuring Success
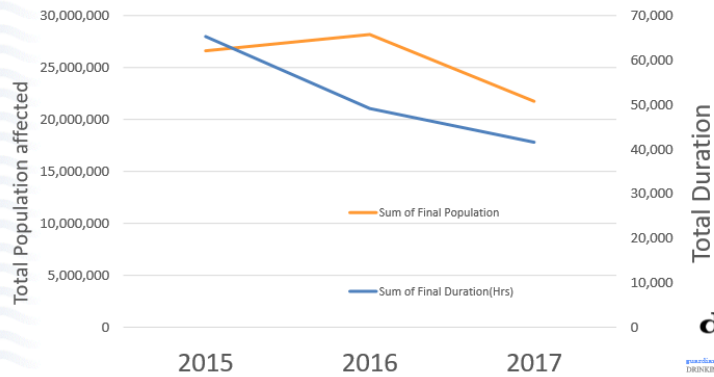
Recommendations & The Likelihood of Regulatory Failure

Company Reference	Final Recommendation Score total	Company Rank	RtR response score
A	575	28	5
B	536	27	4
C	410	26	4
D	387	25	4
E	228	24	4
F	219	23	4
G	156	22	3
H	140	21	3
I	111	20	3
J	110	19	3
K	104	18	3
L	102	17	3
M	79	16	3
N	49	15	2
O	45	14	2
P	27	13	1
Q	17	12	1

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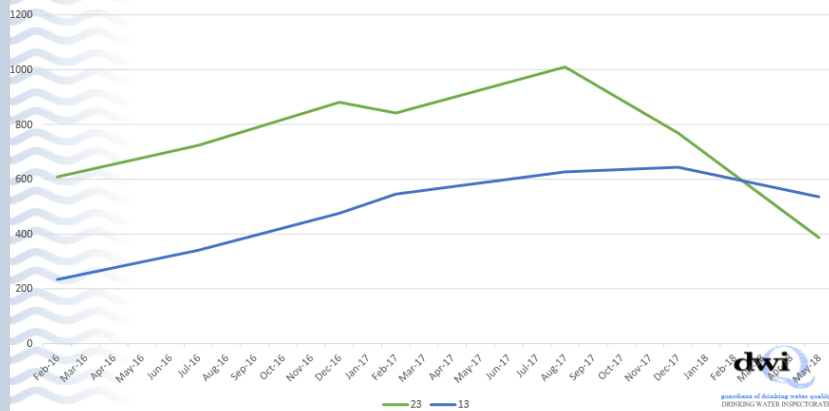
Culture in Corporate Governance

- *G20/OECD Principles of Corporate Governance* (OECD, 2015)

The purpose of corporate governance is to help build an environment of trust, transparency and accountability necessary for fostering long-term investment, financial stability and business integrity, thereby supporting stronger growth and more inclusive societies.

- *The UK Corporate Governance Code* (Financial Reporting Council, July 2018)

A. .. The board should establish the company's purpose, values and strategy, and satisfy itself that these and its culture are aligned. All directors must act with integrity, lead by example and promote the desired culture.

- *The Wates Corporate Governance Principles for Large Private Companies* (Financial Reporting Council, June 2018)

An effective board promotes the purpose of a company, and ensures that its values, strategy and culture align with that purpose.

- *Board leadership, transparency and governance – principles (Ofwat, 2019)*

The regulated company board establishes the company's purpose, strategy and values, and is satisfied that these and its culture reflect the needs of all those it serves.

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Regulating Culture

- An ethical culture cannot be imposed from outside

- Evidence of an organisation's culture can be made available

- An ethical culture can be evidenced and recognised

- It's about evidence of trust

- Some internal and external signs and behaviours can destroy an ethical culture

The Essence of Ethical Business…

- **Practice (EBP) – Creating and being able to provide evidence of an effective ethical culture where employees can:**

  - Do the right thing, **based on ethical values**.
  - Recognise ethical dilemma & are skilled at resolving them
  - Be open and honest: speak up and learn from mistakes

- **Regulation (EBR)**

  A **relationship** between a business and a regulator, in which the **business produces evidence of its on-going commitment to EBP** and the **regulator recognises and encourages** that commitment.
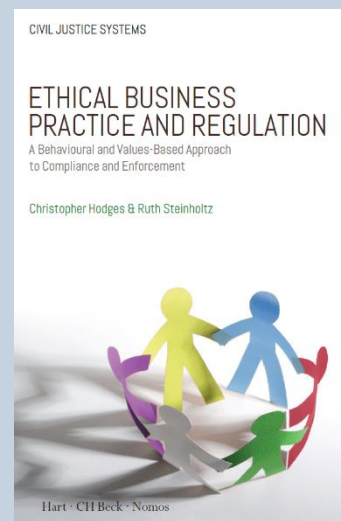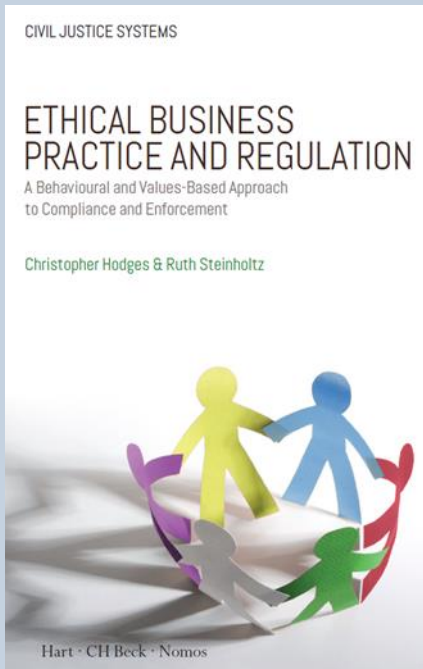
How can you use EBR to increase trust?

The Influences on an Organisation

Elements of Ethical Business Practice

Leadership and Culture Framework

- The Foundation
- People and Ethos
- Aligned Systems and Processes

- Questions to assist leaders
- Examples of types of evidence

Values-based Ethics and Compliance Framework

- Values-based Code, policies and procedures
- Risk assessments, incl. culture
- Communications, face-to-face awareness & training, E A's
- Speak-up in psychological safety
- 3rd party involvement, due diligence
- Collection of evidence for learning and trust building

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The Foundation

'We believe that ethics is everyone's responsibility'

'We clearly understand core (ethical) values, identified through consultation'

'We have a commitment to continuous improvement, based on a just culture'

'We have an articulated, inspirational social purpose'

'We are dedicated to fairness for stakeholders'

'We have a public commitment & evidence of the basis for placing trust in the organisation'

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#EthicalBusinessPractice

People & Ethos

- Leaders who are **fully committed to ethical values** and understand their **role** in creating an ethical culture, and who **set a strong, positive e**xample.

- **Employee involvement** and **engagement** in fostering ethical business practice, such as using **ethics ambassadors**.

- Management with **the personalities and skills** required to promote open communication, ethical decision-making, deep listening and to hold others to account.

- Tolerance and encouragement of **constructive conflict** with **no fear of reprisals** for raising difficult issues.

- A **collaborative atmosphere**—work across functions, business units and cultures with curiosity and respect, and the ability to learn lessons and continuously improve

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Aligned Systems and Processes

- Processes and systems in **alignment with ethical values** and supporting ethical business practice, **embedded in the business**, not separate from it.

- **Performance management** systems and **incentive** schemes that **reward good leadership and ethical behaviours**, not just results, and that **do not foster unethical behaviour**.

- Provision **of clear and adequate information and professional assistance** to support all aspects of EBP.

- **Honest (and challenging) auditing, measurement and monitoring** to enable the organisation to **demonstrate** the existence of a strong ethical culture and the basis for trust.

Values-based ethics & compliance framework

- A written **code of Ethical Business Practice**, *developed from within*, based upon the **organisation's values and aligned with the culture**

- Regular ethical/anti-corruption **risk assessments,** done by the business, with expert support as necessary and **the implementation of mitigation measures** in response to the risks.

- **Clear, succinct policies and procedures** that are easily accessible and kept updated.

- **Regular pattern of (positive) communications** at all levels of management.

- **Training** aimed at informing those doing business on behalf of the organisation as to what is expected of them, mainly conducted **face-to-face** and supplemented online or by other technological means, such as apps.

- A network of **employee ethics ambassadors** to assist in embedding ethical values and to help with communications and training.

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Values-based ethics & compliance Framework

- Development of **ethical decision-making skills**: **recognise** and resolve ethical dilemmas and **effectively implement solutions (GVV)**, using ethical decision-making **models** and **scenario-based training** using **realistic scenarios** developed internally (scenario bank).

- **Adequate resources**

- Effective **due diligence** of third parties, conducted by the business, with support as necessary.

- **Involvement of relevant third parties and strategic partners** in the commitment to ethical business practice, including the supply chain and anyone acting on behalf of the organisation.

- An appropriate mechanism for **speaking up**, catering to the language and cultural characteristics of the organisation; a skilled approach to investigations and discipline, and **a climate of 'psychological safety'**.

- **Monitoring, measuring, tracking and reporting** elements of ethical business practice by various means – to provide **evidence of the effectiveness** of the Framework.

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Implementing EBP + EBR

Approaches & pilot studies

Civil aviation	Medical devices	Workplace Health & Safety	Environment	Trading Standards: Primary Authority
Equality & Human Rights	Gambling	Water pricing	Food standards	Genetic materials
Data protection & privacy	Energy	Water quality	Lawyers	Timber
Universities	International money laundering	Care Homes	Sport	Medicines

Maslow's Needs to Barrett's Consciousness

Abraham Maslow

Richard Barrett

Transcendence

Know and Understand

Self-Actualization

Self-esteem

Love & Belonging

Safety

Physiological

7

6

5

4

3

2

1

Needs

Consciousness

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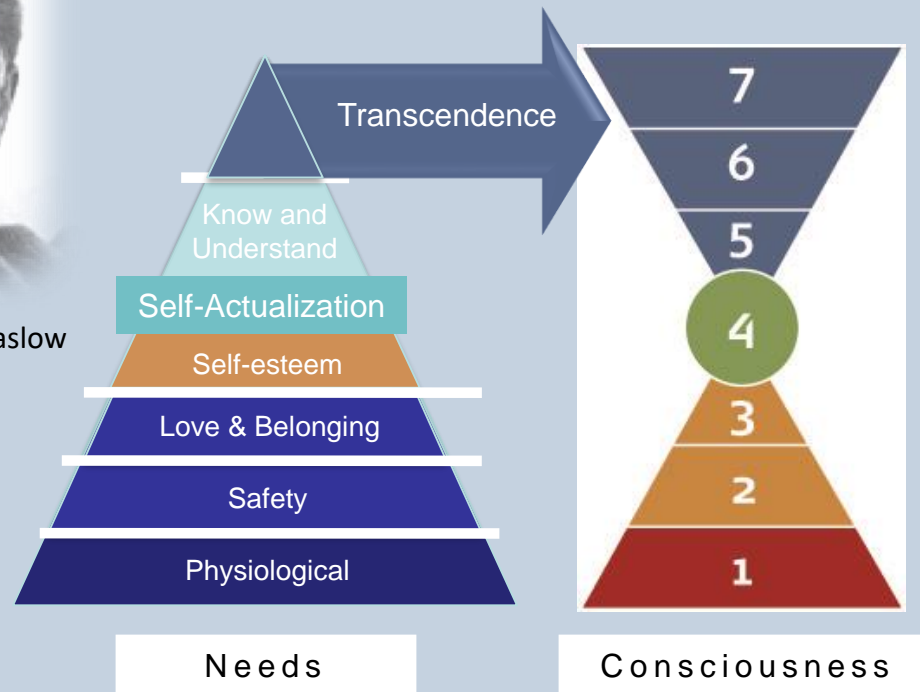
Seven Levels of Organisational Consciousness (Focus): Full Spectrum Awareness

Level		Title	Description
Service	7	Service to Humanity and the Planet	Social responsibility, future generations, long-term perspective, ethics, compassion, humility
Making a Difference	6	Strategic Alliances and Partnerships	Environmental awareness, community involvement, employee fulfilment, coaching/mentoring
Internal Cohesion	5	Building Internal Community	Shared values, vision, commitment, integrity, trust, passion, creativity, openness, transparency
Transformation	4	Continuous Renewal and Learning	Accountability, adaptability, empowerment, teamwork, goals orientation, personal growth
Self Esteem	3	High Performance	Systems, processes, quality, best practices, pride in performance. Bureaucracy, complacency
Relationship	2	Employee Recognition	Loyalty, open communication, customer satisfaction, friendship. Manipulation, blame
Survival	1	Financial Stability	Shareholder value, organisational growth, employee health, safety. Control, corruption, greed

Barrett Values Centre
Powerful metrics that enable leaders to measure and manage cultures.

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Engineering and Projects Company (339)

Personal Values	Current Culture Values	Desired Culture Values

Level 7

Level 1

The values that are important to employees in their personal lives.

What employees believe is necessary for the company to achieve its full potential
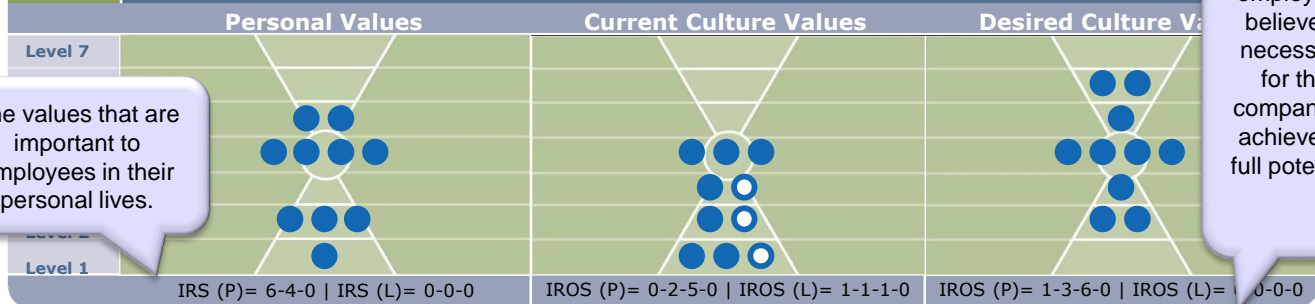
IRS (P)= 6-4-0 | IRS (L)= 0-0-0   IROS (P)= 0-2-5-0 | IROS (L)= 1-1-1-0   IROS (P)= 1-3-6-0 | IROS (L)= 0-0-0

Matches

PV - CC 1
CC - DC 4
PV - DC 2

Health Index (PL)

PV: 10-0
CC: 7-3
DC: 10-0

Personal Values			Current Culture Values			Desired Culture Values		
1. honesty	169	5(I)	1. *continuous improvement*	111	4(O)	1. *accountability*	180	4(R)
2. *accountability*	165	4(R)	2. *customer satisfaction*	111	2(O)	2. *customer satisfaction*	147	2(O)
3. **commitment**	150	5(I)	3. safety conscious	102	1(O)	3. *continuous improvement*	143	4(O)
4. continuous learning	92	4(I)	4. cost reduction	88	1(O)	4. employee development	111	4(O)
5. balance (home/work)	91	4(I)	5. job insecurity (L)	77	1(O)	5. employee recognition	96	2(R)
6. family	91	2(R)	6. inconsistent (L)	75	3(I)	6. **commitment**	95	5(I)
7. self-discipline	91	1(I)	7. *teamwork*	74	4(R)	7. inspirational leadership	95	6(O)
8. responsibility	89	4(I)	8. *accountability*	71	4(R)	8. employee fulfilment	94	6(O)
9. respect	81	2(R)	9. blame (L)	71	2(R)	9. *teamwork*	90	4(R)
10. open communication	76	2(R)	10. corporate image	64	3(O)	10. professionalism	80	3(O)

How employees experience the company - What is working well? What is undermining the sustainability of the company.

Black Underline = PV & CC
Orange = PV, CC & DC

... ividual   O = Organizational
... lationship   S = Societal

Values Plot   February 2011

Thank you